

City of Detroit

CITY COUNCIL

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TO: COUNCIL MEMBERS

FROM: Irvin Corley, Jr., Director *ICJ*

DATE: March 9, 2007

RE: City Council Fiscal Analysis Division's Reaction to the Budget Department's Quarterly Financial Report as of December 31, 2006

Council asked that the Fiscal Analysis Division react to the Budget Department's financial report referenced above, which is attached.

Council will note that this Quarterly Financial Report will appear as a line item on Monday's (the 12th's) calendar for a response from Fiscal. Given the issuance date of this report, coupled with the issues and concerns we raise below, we will respectfully request on Monday that the Budget Department respond to questions raised below within two weeks from the 12th, March 26th.

Two weeks is suggested because the Budget Department is currently in the middle of putting together the Mayor's proposed budget for fiscal year 2007-08, which obviously is a very intensive time for the department.

Questions and Possible Actions

In response to the Quarterly Financial Report for the period ending December 31, 2006, the Fiscal Analysis Division is submitting the following questions and possible actions for the consideration of City Council.

The communication from the Budget Department lists the following initiatives included in the 2006-07 Budget as completed. In order to give Council a better understanding of these initiatives, Council may want to request specific detail on these items, such as the amount of savings anticipated and included in the 2006-07 Budget and the actual amount of savings identified by the Budget Department in their analysis with the supporting detail where available.

Completion of the following table by the administration would be a suggested method to present the information along with the underlying assumptions. Providing this type of information will assist the Fiscal Analysis Division in improving our future projections for Council.

Items identified as savings initiatives only affect the surplus/deficit when the amount of savings actually realized differs from the savings included in the budget.

Initiative	Savings included in Budget	Actual Savings	Effect on Surplus/Deficit
10% salary reduction for union personnel, excluding Police & Fire			
Refinancing of the Pension Obligation Certificates			
Health Care Plan Design			
Contribution Changes (Health Plan ?)			
Reduction in Administrative Fees and Rates			
Solid Waste Collection Fees			

Council is aware that the Fiscal Analysis Division provided an extensive report for the general fund with a projection to the end of the fiscal year. That report was based on information in the financial reporting system through December 31, 2006, and it indicated that our analysis, based on the included assumptions that accompanied the report, projects a \$63.0 million operating deficit for the 2006-07 fiscal year. Since Council, or the Fiscal Analysis Division, has not received any response from the administration on that projection, Council should request an explanation on the statement "we are optimistic that the City will be able to complete the current fiscal year with a balanced budget", in comparison with Fiscal's. The administration should also outline the major items that would explain the \$63 million difference.

Comparison between Fiscal's and Budget's December 31st Financial Reports

Below is a comparison of items included in both reports. As Council will remember, the Quarterly Financial Report is very limited in nature as it only includes five major revenues and seven departments, as required by a court direction.

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Revenues:

Account	Budget's Quarterly Report		Fiscal Analysis (A)
	Worst Case	Best Case	
Income Tax	(\$16,000,000)	\$0	\$8,600,000
Current Year Property Tax	0	0	(15,900,000)
Utility Users' Tax	3,500,000	4,000,000	(9,800,000)
State Equity	0	0	0
State Revenue Sharing	(8,156,930)	(8,156,930)	(8,200,000)
Total	(\$20,656,930)	(\$4,156,930)	(25,300,000)

(A) The projection of these revenues items was based on the information in the financial reporting system of the city through December 31, 2006. When we met with the representatives of the Finance and Budget Department other data was offered to support the administration's estimates. This data has not been received. A second question would then be: Why isn't collection data entered into the financial reporting system in a timely fashion?

Appropriations:

Agency	Budget's Quarterly Report		Fiscal Analysis
	Worst Case	Best Case	
Department of Public Works	(\$2,200,000)	\$0	\$1,663,741
Finance	600,000	1,000,000	3,138,348
Fire	(3,300,000)	(1,000,000)	(12,323,647)
Health	500,000	1,500,000	8,055,004
Police	750,000	900,000	(2,685,184)
Public Lighting	(5,000,000)	0	(1,282,549)
Recreation	(2,300,000)	0	(5,495,001)
Total	(\$10,950,000)	\$2,400,000	(\$10,593,209)

To summarize the two tables, on the revenue side, our estimate of a deficit is slightly higher than the Budget Department's least optimistic estimate for the five major revenues. And on the appropriation side our estimate for the seven departments is just below the least optimistic estimates from the Budget Department report. It is interesting to note, that while there are differences in the details, when combined our estimates are not that different. Not surprisingly, however, the Fiscal Analysis Division projections tend to match the less optimistic projections from the administration.

As always I am available to meet with members of the administration to identify and where possible, resolve the differences of opinion or assumptions in the projections.

Deficit Reduction Plan Response

In response to Council Member JoAnn Watson's request for a deficit reduction plan from the administration, it is first important to distinguish between a formal "deficit reduction/elimination plan" that is submitted to the State, and a deficit elimination/cut plan that is submitted to City Council.

Deficit Reduction/Elimination Plan that is submitted to the State

After the City determines that it is ending up with a deficit at the end of a fiscal year, Public Act 140-State Revenue Sharing Act requires that the City present a deficit elimination plan to the State within 90 days after the beginning of the fiscal year to correct the deficit. Appendix I contains the exact language from this act.

It is important to note that it appears the State act does not require that the plan be submitted to the local legislative body. However, as a courtesy, the administration should submit a copy to Council whenever it is submitted to the State.

It is also not clear whether the deficit for the fiscal year has to be presented in the City's annual financial report, which is also known as the Comprehensive Annual Financial Report (CAFR), to be the vehicle to make the deficit "known". Although Appendix I shows that subsection (1) requires that the City provide an annual financial report to the State, there does not appear to be a direct tie with subsection (2) that speaks to the elimination of the deficit once the deficit is "known" for the fiscal year. Council may request that the Research and Analysis Division provide a legal analysis on this question.

The 2004-05 Deficit

Council will recall that the administration submitted a deficit elimination plan around June of 2004 to the State Treasurer in order to sell \$65 million in Fiscal Stabilization Bonds to help cover the 2002-03 \$69 million budget deficit. Eventually, \$61 million from the fiscal stabilization bonds and \$8 million from the budget stabilization fund, or "rainy day fund", covered the \$69 million deficit. The transfer from the budget stabilization fund fully depleted the fund.

The deficit elimination plan submitted to the State Treasurer addressed fiscal years 2002-03, 2003-04 and 2004-05. The plan spoke to a \$214 million structural General Fund deficit, and that measures would have to be taken (1,500 to 2,000 layoffs and \$150 million in one-time revenue enhancements from POCs and self-insurance bonds, etc.) to address this structural deficit.

Despite this plan, Council knows that fiscal year 2004-05 ended up with a \$155 million accumulated deficit. **To our knowledge, a deficit elimination plan to address the \$155 million deficit was not submitted to the State Treasurer. If a plan was submitted, then your Honorable Body should request to receive a copy of the plan from the administration.**

The 2005-06 Deficit

Council will recall that the current 2006-07 year budget has \$67 million in the Prior Year Deficit appropriation, which was the initial projected amount for the 2005-06 budget deficit.

As of August 31, 2006, the financial reporting system, along with known year-end adjustments, indicated an approximate \$187 million budget deficit for 2005-06. Arguably, the administration should have at least drafted a deficit elimination plan to address this deficit to be ready for submission to the State Treasurer. A deficit was "known" at that time.

We now feel the deficit for 2005-06 will be in the \$163 million range. It is at this lower level primarily because of the \$28 million the General Fund received from the Greentown garage sale. At any rate, the administration should have a deficit elimination plan available to address the 2005-06 deficit that exceeds the budgeted level of \$67 million. That would be \$96 million if the deficit close to the \$163 million level.

Council should ask the administration for a copy of the 2005-06 budget deficit elimination plan, if such plan is available; and whether such a plan has been submitted to the State Treasurer.

If the language in Appendix I from the State Revenue Sharing act is interpreted to mean that a deficit elimination plan is required to be submitted to the State Treasurer when the deficit for a fiscal year is "known" through an audited annual financial report, such as the CAFR, then most likely the administration has not prepared a formal deficit elimination plan because the CAFR as of June 30, 2006 (or fiscal year 2005-06) is not completed yet. It is my understanding that this CAFR may not get done until April 2007 and, this prediction appears optimistic.

Deficit Reduction/Elimination Plan that is submitted to the City Council

In accordance with the Uniform Budgeting and Accounting Act (Act 2 of 1968), the Mayor is required to submit a deficit elimination plan to the Council for approval whenever the Mayor **or** the City Council **during a fiscal year** determines that actual revenues are less than estimated revenues. The plan is to offer recommendations that prevent expenditures from exceeding the available revenues. Appendix II contains the actual language from the State act.

The one caveat is that according to the Stecher case, the Mayor has the power to take measures in advance, or ahead of time of the submission of the deficit elimination plan, to avoid exacerbating a projected budget shortfall (reference: a report entitled "Budget Savings Resolutions and Scheduled Public Meetings Relative to Bus Service Disruption" dated January 27, 2005).

Let's look at some examples in recent years.

The 2000-01 Deficit

Mayor Dennis Archer faced a looming \$75 million budget deficit for 2000-01, and he submitted a "cut plan" to the City Council to address this projected deficit and end up with a small surplus, in the neighborhood of \$25 million. The cut plan addressed \$50 million and a \$50 million sale of the entire Dehoco site was on the table. The Fiscal Analysis Division recommended approval of this sale.

This proposed sale of Dehoco was not approved by Council to give the new incoming Mayor, Kwame Kilpatrick, the opportunity to gain control of the Dehoco property sale process. Meanwhile, the City ended up with a \$26 million deficit for 2000-01. Mayor Kilpatrick tapped the Budget Stabilization Fund for \$26 million to cover this deficit.

It should be noted that 2001-02 finished with a \$1.6 million surplus.

The 2002-03 Deficit

As mentioned previously, the Mayor addressed the 2002-03 \$69 million deficit by the City floating \$65 million in Fiscal Stabilization Bonds and transferring the remaining \$8 million from the Budget Stabilization Fund.

The 2003-04 Deficit

During January 2005, Mayor Kilpatrick submitted a deficit reduction plan to address an anticipated \$94 million budget deficit. Council had lengthy discussions about the plan but did not formally adopt the plan.

The City ended up with a \$95 million budget deficit for 2003-04.

The 2004-05 Deficit

The January 2005 report also indicated that fiscal year 2004-05 would end with a projected \$64 million deficit, and that this deficit would be addressed in the Mayor's 2005-06 budget recommendation.

As indicated above, a deficit elimination plan was submitted to the State Treasurer that reportedly addressed the 2004-05 deficit. The year ended up with a \$155 million deficit. At no time after January 2005 did the Mayor submit a deficit elimination plan to Council for consideration to address the 2004-05 deficit.

The 2005-06 Deficit

Council has yet to receive a deficit elimination plan from the Mayor to address the 2005-06 deficit. We now believe that this deficit is around \$163 million; the projected deficit in the budget is \$67 million. This means that the Mayor needs to eliminate the \$96 million difference.

Council should request that the Mayor present a deficit elimination plan to address the \$96 million deficit difference to your Honorable Body as soon as possible.

The 2006-07 Deficit

As you know, the Fiscal Analysis Division submitted to your Honorable Body a report entitled "Budget Monitoring Report for the 2006-07 Fiscal Year" dated February 27, 2007 that includes our projected operating deficit of \$63 million for the current 2006-07 fiscal year.

Again, our read of the language from the Uniform Budget and Accounting Act, as depicted in Appendix II, suggests that the Mayor must present a deficit elimination plan to Council for consideration and approval to address the projected \$63 million deficit made known by Council's Fiscal Analysis Division.

We suggest that Council ask the Research and Analysis Division to do a legal analysis to determine if our interpretation of the language in Appendix II from the Uniform Budgeting and Accounting Act is correct.

In addition, we recommend that Council pass a resolution formally indicating your Body's concurrence that the City could end up with a \$63 million deficit, per Fiscal's report.

We further recommend that Council formally request from the Mayor a plan to address the \$63 million. Of course, if the Mayor does not agree with our projection, he should indicate why. If his projection is lower, then a plan should be submitted to Council to address the lower deficit.

Known Appropriation Deficits as of December 31st in the 2006-07 Budget

Our Budget Monitoring Report for the 2006-07 Fiscal Year identified 40 general fund appropriations in 14 agencies that as of December 31, 2006 are showing deficits totaling more than \$10 million.

The City Charter states:

Sec. 8-302. Limit on obligations and payments.

No obligations shall be incurred against, and no payments shall be made from, any allotment or appropriation except in accordance with appropriations duly made and unless the chief accounting officer or in absence of the chief accounting officer, a designee of the finance director advises that there is a sufficient unencumbered balance in the allotment or appropriation and that sufficient funds will be or are available to meet the obligation.

When the chief accounting officer or in absence of the chief accounting officer, a designee of the finance director so advises, the obligation may be incurred or payment made in accordance with any applicable procedure established under section 6-306.

Sec. 8-303. Penalties for violation.

Any incurring of obligation or authorization of payment in violation of the provisions of this Charter shall be void and any payment so made illegal; the action shall be cause for removal of any officer who knowingly incurred the obligation or authorized to make the payment, and he or she shall also be liable to the city for any amount so paid and to any criminal sanctions imposed by law or ordinance.

Sec. 8-304. Obligations to be met by subsequent appropriation.

As permitted by law, the city may by resolution of the city council:

1. Make contracts or make or authorize payments for capital improvements to be financed wholly or partly by the issuance of bonds; or
2. Make any contract or lease (including installment contracts, lease-purchase contracts or other forms of deferred payment contracts for the acquisition of real property or capital equipment) providing for payments beyond the end of the fiscal year.

Council may wish to call the chief accounting officer, or other designee of the finance director to explain why these appropriations in a deficit status as of Dec. 31, 2006, and in some if not all, expenditures continue to be made. In my estimation this violates the charter. A review of the penalty language above indicated the seriousness that the writers of the charter placed on appropriation control.

Outstanding Questions

The following are some additional questions that we feel the administration should answer for the Council.

What is the administration's position compared to the projection made by Fiscal Analysis?

When will the administration submit amendments to the budget to clear the existing deficits?

What is the administration's current estimate of the June 30, 2006 deficit for the general fund (and all other funds that will be reported as deficit) in regards to the requirement to submit a "deficit reduction plan" to the state treasurer?

When was it determined by the administration that the Prior Year Deficit appropriation for 2006-07 was insufficient?

Why hasn't a deficit elimination or cut plan to cover the remaining prior-year deficit been submitted to Council or been implemented by the administration? This cut plan would reduce the prior year deficit appropriation that will be necessary in the 2007-08 budget.

Attachment

cc: Council Divisions
Auditor General's Office
Pam Scales, Budget Director
Renee Short, Budget Team Leader
Roger Short, Chief Financial Officer
Kandia Milton, Mayor's Office

ICJ:\ICORLEY\Reaction to Qrtly Financial Rpt 12 31 06.doc



CITY OF DETROIT
BUDGET DEPARTMENT

NOTE TO COUNCIL:
THIS MATTER WILL BE
BROUGHT INTO COMMITTEE

ON MONDAY MAR 5 2007

2 WOODWARD AVE., SUITE 1100
DETROIT, MICHIGAN 48226
PHONE 313•224•6260
FAX 313•224•2827
WWW.CI.DETROIT.MI.US

February 28, 2007

HONORABLE CITY COUNCIL:

Re: Quarter Financial Report

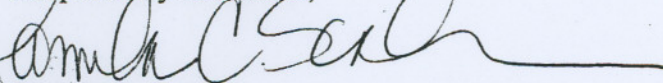
I am herewith submitting to your Honorable Body the quarterly financial report for the period ending December 31, 2006.

As previously reported in the quarterly financial report for the period ending September 30, 2006, we have completed the majority of the fiscal initiatives reflected in the 2006-2007 Budget. These initiatives included the 10% salary reduction from union personnel excluding Police and Fire. Union personnel are continuing to either take DOWOP days or working fewer hours to achieve the savings. We have realized the anticipated savings of the \$20 million from refinancing the Pension Obligation Certificates (POCs). Also, the anticipated savings from healthcare plan design, contribution changes, reduction in administrative fees and rates, and collection of the solid waste fees is being realized.

Based upon our review of the financial data for the period ending December 31, 2006, we are optimistic that the City will be able to complete the current fiscal year with a balanced budget. We will continue to actively monitor expenditures and will provide your Honorable Body with an in depth departmental review of the 2006-2007 Budget in April. As in prior years, this information will be factored in the Mayor's Proposed Budget for 2007-2008.

I will be available for any questions and or concerns.

Respectfully submitted,


Pamela C. Scales
Budget Director

cc: Kwame M. Kilpatrick, Mayor
Anthony Adams, Deputy Mayor
Roger Short, Chief Financial Officer
Kandia Milton, City Council Liaison

Copy given Council
03-01-07 (RJ)

PART I -
GENERAL FUND
MAJOR SOURCES OF REVENUE AND ESTIMATED SURPLUS/(DEFICIT)
As of December 31, 2006

	Total Annual Budget	Amount Collected through 12/31/06	Better/(Worse) than Budget Year to Date	% Variance Better/(Worse) than Budget Year to Date	Remaining Annual Budget	% Collected to Date		Estimated Year End Surplus/(Deficit) Manually Computed
						Current Year	Prior Year	
Municipal Income Tax	\$271,405,000	\$121,037,195	(\$14,665,305)	-10.81%	\$150,367,805	44.60%	44.60%	\$0 - (\$16,000,000)
Current Year Property Tax	165,957,033	99,457,245	16,478,728	19.86%	66,499,788	59.93%	52.29%	0
Utility Users' Tax	56,000,000	13,621,892	(14,378,108)	-51.35%	42,378,108	24.32%	26.09%	\$3,500,000 - \$4,000,000
State Equity Package								
Zoo	\$0	\$327,094	\$327,094	0.00%	(\$327,094)	0.00%	26.01%	\$0
Total	\$0	\$327,094	\$327,094	0.00%	(\$327,094)	0.00%	38.36%	\$3,500,000 - (\$12,000,000)
State Revenue Sharing								
Sales Tax - Constitutional	\$66,000,000	\$11,304,297	(\$21,695,703)	-65.74%	\$54,695,703	17.13%	17.08%	(\$1,315,442)
Sales Tax - Statutory	216,559,208	35,682,475	(72,597,129)	-67.05%	180,876,733	16.48%	16.76%	(6,841,488)
Total	\$282,559,208	\$46,986,772	(\$94,292,832)	-66.74%	\$235,572,436	16.63%	16.84%	(\$8,156,930)
Grand Total	\$775,921,241	\$281,430,198	(\$106,530,423)	-27.46%	\$494,491,043	36.27%	35.26%	\$3,500,000 - (\$20,156,930)

GENERAL FUND APPROPRIATIONS
(including fringe benefits)
ESTIMATED SURPLUS/(DEFICIT)
as of December 31, 2006

	Total Annual Budget	Amount Expended through December 31, 2006	Better/(Worse) than Budget Year to Date	% Variance Better/(Worse) than Budget Year to Date	Remaining Annual Budget	% Expended to Date		Estimated Year End Surplus/(Deficit) Manually Computed
						Current Year	Prior Year	
DEPT OF PUBLIC WORKS	\$126,233,304	\$98,948,189	(\$35,831,537)	-56.77%	\$21,630,642	78.39%	81.90%	\$0 - (\$2,200,000)
FINANCE	34,819,665	14,629,121	2,780,712	15.97%	17,851,459	42.01%	39.22%	600,000 - 1,000,000
FIRE	173,188,456	90,668,734	(4,074,506)	-4.71%	78,557,977	52.35%	55.71%	(1,000,000) - (3,300,000)
HEALTH	28,999,722	9,642,925	4,856,936	33.50%	17,786,942	33.25%	38.79%	500,000 - 1,500,000
POLICE	399,515,665	199,241,893	515,940	0.26%	197,751,246	49.87%	54.07%	750,000 - 900,000
PUBLIC LIGHTING	64,409,517	27,117,470	5,087,288	15.80%	27,573,494	42.10%	64.43%	0 - (5,000,000)
RECREATION	20,039,567	10,363,781	(343,997)	-3.43%	5,072,290	51.72%	55.61%	0 - (2,300,000)
TOTAL	\$847,205,896	\$450,612,112	(\$27,009,164)	-6.38%	\$366,224,050	53.19%	58.48%	\$850,000 - (\$9,400,000)

NOTE: Fringe Benefits (entire General Fund, excluding pensions) are estimated to surplus/deficit in the amount of (\$0).

Appendix I

GLENN STEIL STATE REVENUE SHARING ACT OF 1971 (EXCERPT) Act 140 of 1971 (as amended in 1996)

141.921 Withholding payments until submission of financial report or audit; filing, evaluation, certification, and institution of financial plan to correct deficit condition; noncompliance; notification of legislature; "deficit condition" defined.

Sec. 21.

(1) If a city, village, township or county fails to provide an annual financial report or audit which conforms with the minimum procedures and standards prescribed by the state treasurer and is required under Act No. 2 of the Public Acts of 1968, as amended, being sections 141.421 to 141.440a of the Michigan Compiled Laws, or Act No. 71 of the Public Acts of 1919, being sections 21.41 to 21.53 of the Michigan Compiled Laws, the payments required under this act may be withheld until the financial report or audit is submitted as required by law.

(2) For a fiscal year of a unit of local government ending on or after October 1, 1980 or any year thereafter, if a local unit of government ends its fiscal year in a deficit condition, the local unit of government shall formulate and file a financial plan within 90 days after the beginning of the fiscal year to correct this condition. Upon request of a local unit of government the department of treasury may assist that local unit in the formulation of the financial plan to correct the deficit condition. The local unit of government shall file the financial plan with the department of treasury for evaluation and certification that the plan ensures that the deficit condition is corrected. Upon certification by the department of treasury, the local unit of government shall institute the plan. An amount equal to 25% of each payment to a local unit of government entitled to payments under this act may be withheld until requirements of this subsection are met.

(3) The department of treasury shall notify each house of the legislature of any local unit of government that fails to provide a financial report or an audit required by subsection (1) and of any local unit of government required to file a financial plan under subsection (2).

(4) As used in this section, "deficit condition" means a situation where, at the end of a fiscal year, total expenditures, including an accrued deficit, exceeded total revenues for that fiscal year, including any surplus carried forward.

History: Add. 1980, Act 275, Imd. Eff. Oct. 8, 1980

The Fiscal Analysis Division added emphasis to this section.

Appendix II

Excerpt from the UNIFORM BUDGETING AND ACCOUNTING ACT (Act 2 of 1968, as amended in 1996)

141.437 General appropriations act; amendment; reports; recommendations.

Sec. 17.

(1) Except as otherwise provided in section 19, a deviation from the original general appropriations act shall not be made without amending the general appropriations act. Subject to section 16(2), the legislative body of the local unit shall amend the general appropriations act as soon as it becomes apparent that a deviation from the original general appropriations act is necessary and the amount of the deviation can be determined. An amendment shall indicate each intended alteration in the purpose of each appropriation item affected by the amendment. The legislative body may require that the chief administrative officer or fiscal officer provide it with periodic reports on the financial condition of the local unit.

(2) If, during a fiscal year, it appears to the chief administrative officer or to the legislative body that the actual and probable revenues from taxes and other sources in a fund are less than the estimated revenues, including an available surplus upon which appropriations from the fund were based and the proceeds from bonds or other obligations issued under the fiscal stabilization act, 1981 PA 80, MCL 141.1001 to 141.1011, or the balance of the principal of these bonds or other obligations, **the chief administrative officer or fiscal officer shall present to the legislative body recommendations which, if adopted, would prevent expenditures from exceeding available revenues for that current fiscal year.** The recommendations shall include proposals for reducing appropriations from the fund for budgetary centers in a manner that would cause the total of appropriations to not be greater than the total of revised estimated revenues of the fund, or proposals for measures necessary to provide revenues sufficient to meet expenditures of the fund, or both. The recommendations shall recognize the requirements of state law and the provisions of collective bargaining agreements.

History: Add. 1978, Act 621, Eff. Apr. 1, 1980 ;-- Am. 1981, Act 77, Imd. Eff. June 30, 1981 ;-- Am. 1995, Act 41, Imd. Eff. May 22, 1995 ;-- Am. 2000, Act 493, Imd. Eff. Jan. 11, 2001

The Fiscal Analysis Division added emphasis to this section.